1992

Brown Plumbing & Heating Co. v. Utah State Tax Commission : Brief of Petitioner

Utah Court of Appeals

IN THE COURT OF APPEALS OF THE STATE OF UTAH

BROWN PLUMBING & HEATING CO.,	:	
Petitioner,	:	Case No. 920402
vs.	:	Priority No. 15
UTAH STATE TAX COMMISSION,	:	
Respondent.	:	

PETITIONER'S BRIEF

ON PETITION FOR REVIEW OF FINAL DECISION
OF THE UTAH STATE TAX COMMISSION

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STATEMENT OF JURISDICTION

The Petition for Review was originally filed in the Utah Supreme Court, which issued a Writ of Review under Supreme Court No. 920181. Pursuant to U.C.A. § 78-2-2(4), as amended in 1992, the Supreme Court transferred the case to this Court, which now has jurisdiction pursuant to section 78-2a-3(2)(k), as amended.

STATEMENT OF ISSUES PRESENTED FOR REVIEW

1. Whether the Tax Commission erroneously applied state statutes and regulations in imposing a sales tax on petitioner, as subcontractor, for school construction materials purchased directly by the school district as a tax-exempt entity.

Standard of Review: Correction of error. *Morton International, Inc. v. Auditing Division of the Utah State Tax Commission*, 814 P.2d 581, 585-89 (Utah 1991)[1]

2. Whether the Tax Commission erroneously applied state statutes and regulations in alternatively imposing a use tax on petitioner, as subcontractor, for school construction materials purchased in Utah directly by the school district as a tax-exempt entity.

Standard of Review: Correction of error. *Morton International, Inc., supra.*

3. Whether the Tax Commission violated Utah statutes or the Utah Constitution by imposing an effectual tax on the school district, a tax-exempt entity.

Standard of Review: Correction of error. *Morton International, Inc., supra*, at 585.

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[1] This action was commenced in the Tax Commission prior to January 1, 1988; accordingly, the three-tier standard of review in effect prior to the Administrative Procedure Act applies in this case. U.C.A. § 63-46b-22. The correction-of-error standard applies here because the issues on appeal concern statutory and contract interpretation that the court is as well-suited to determine as the agency.

GOVERNING LEGAL PROVISIONS

This case is governed by the following legal provisions, which are set out verbatim in the Addendum (hereafter "Add."): U.C.A. §§ 59-12-102, -103, and -104 of the Sales and Use Tax Act (Add. 138); Utah Administrative Code §§ R865-19-42S, and -58S (Add. 149); Utah Constitution Art. V, § 1; Art. VI, § 1; Art. X, §§ 1, 5; and Art. XIII, §§ 11, 12 (Add. 151).

STATEMENT OF THE CASE

In this review proceeding, petitioner seeks a redetermination of the sales or use tax deficiency assessed against it by the Auditing Division of the Utah State Tax Commission. The tax deficiency was assessed against petitioner for building materials that petitioner incorporated into the construction of a public school building. Petitioner requested redetermination on the grounds that the materials in question were purchased directly by the school district, not by petitioner, and that the transactions were therefore exempt from any tax. (R. 292, Add. 30.) The parties conducted discovery, and the Tax Commission held a formal evidentiary hearing on the issues on July 11, 1991. The Commission thereafter entered its Findings of Fact, Conclusions of Law, and Final Decision upholding the deficiency assessment. (R. 6, Add. 1.) Petitioner subsequently filed a petition for review in the Utah Supreme Court, which issued a writ of review and transferred the case to this Court. (R. 1.)

STATEMENT OF FACTS

In 1985, the Board of Education of Alpine School District ("Alpine"), a political subdivision of the State of Utah and a tax-exempt entity under state law, determined to

construct a new junior high school in Utah County, known as Cedar Hollow Jr. High School ("Project"). Alpine desired to purchase the major construction materials directly in order to benefit from its tax-exempt status and thereby reduce the cost of construction to the public. Based on consultations with, and directives from, the Tax Commission, Alpine drafted the bidding instructions and construction contracts to provide for Alpine's direct supervision of the Project, as well as its direct purchase of construction materials. Dr. Harold Jacklin, Alpine's Director of Physical Facilities, was assigned by the Alpine Board of Education to supervise all phases of planning, financing, and construction of the project, including coordination of the architect and contractors. John Holden, a trained architect and construction supervisor, was employed by Alpine to assist Dr. Jacklin with regular on-site inspections of the Project to ensure receipt of ordered materials and compliance with plans and specifications. Dennis Cecchini, of MHT Architects, was the contracting architect for the Project. (Stipulated Facts, R. 205, Nos. 3-6, 11-12, 25-33, Add. 40, 42, 46; Findings of Fact 10, 18-20, Add. 5-7; Hearing Transcript, July 11, 1991, hereafter "Tr.," at 66-74, 131-32, 146; Holden Dep., in Record as Exh. P-7, at 3-16.)

On June 4, 1985, Alpine entered into an Agreement with Paulsen/Ellsworth Construction Company ("Paulsen") for Paulsen to act as "Contractor" on the Project. (R. 31, Exh. R-1, Add. 51.) In addition to this Agreement, the "contract documents" governing the Project included the standard form General Conditions of the Contract for Construction (R. 134, Add. 71); Supplemental General Conditions (see Part J, R. 55, Exh. P-2, Add. 91); plans and specifications (see Section 15D-Plumbing Specifications, R. 59, Exh. P-3, Add. 98); written interpretations of the contract documents, including

Instructions to Bidders; and work change orders. (See Agreement, Article VI, Add. 58; Stipulated Facts 4-11, Add. 40-42; Finding of Fact 3, Add. 2.)

The Agreement provided that Paulsen would be responsible for construction of the Project, under the direction and supervision of Alpine (through Jacklin and Holden) and the Project architect. (Add. 54-56, 59.) The Agreement required Paulsen to furnish all materials for the Project, *unless* Alpine elected to modify that requirement through a change order allowing Alpine to purchase the materials directly. (Stipulated Fact 12, Add. 42; Findings of Fact 3-4, 8, Add. 2-5.) The Agreement expressly accorded Alpine "the right to furnish any part or all of the materials and equipment which shall become part of the permanent structure." (Add. 59.) Pursuant to this provision, Alpine was to determine which of the needed materials it would purchase directly, send purchase orders for those items directly to the suppliers, take title to the materials directly from the suppliers, "without any vesting in the Contractor" (*id.*), and make payment for the materials directly to the suppliers. The contract price in the Agreement was to be reduced by any amounts expended directly by Alpine for materials, as well as by the sales tax that would have been paid had the materials been supplied by the Contractor. Upon Alpine's exercise of the right of direct purchase of materials, the Contractor was relieved from providing those same materials. The Contractor's only responsibility for direct-purchased materials was to store them after delivery until incorporation into the building. The direct purchase provisions essentially converted the Agreement from a traditional "furnish and install" contract to an "install only" contract. The net effect of the Agreement was that Alpine retained most of the administrative, supervisory, and purchasing functions

of a traditional "general contractor." (Add. 52, 59-62, 67-68; Tr. 25-26, 74-76, 81, 95, 135-41, 163, 172; Holden Dep. at 10-16; Finding of Fact 4, Add. 2-5.)[2]

Contemporaneous with the Alpine-Paulsen Agreement, Paulsen entered into a Subcontract Agreement with petitioner, Brown Plumbing & Heating Co. ("Brown"), for Brown to perform the mechanical and plumbing work for the Project. This Subcontract incorporated all the terms of the prime contract documents, discussed above:

> The Contractor and the Subcontractor agree to be bound by the terms of the prime contract agreement, construction regulations, general conditions, plans and specifications, and any and all other contract documents, if any there be, insofar as applicable to this subcontract agreement, and to that portion of the work herein described to be performed by the Subcontractor. [Exh. P-1, R. 51, p. 1, Add. 118.]

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[2] The Supplementary Conditions to the contract (Part J, paragraph 20) specifically reaffirmed Alpine's right of direct purchase of materials, with the duty of storage following delivery on the Contractor:

> 20. DIRECT PURCHASES BY SCHOOL DISTRICT:
>
> The Owner, at its sole option and discretion, may purchase certain major items and quantities of materials from the specifications for utilization in the project by writing Purchase Orders directly to suppliers of said major items in the Contract. The General Contractor and its subcontractors, when requested to do so by the Owner, shall make a list of materials and their cost which materials can be purchased directly in said manner. When approved by the Owner, the Owner may then provide purchase requisitions upon which the Contractor will specifically state its needs and schedules for delivery dates. Such Purchase Orders may then be written by the Owner from such requisitions. The Purchase Order amount plus the sales tax amount will be deducted from the total Contract amount. Invoices received upon receipt of delivery of material to the project site will be sent to the Owner for direct payment.
>
> The Contractor shall in all such cases hold the Owner harmless for any losses, claims, defects, discrepancy, delays in delivery or other problems relating to such materials except where any such failure is attributable to the negligent acts of [sic] omissions by the Owner.
>
> All risk of loss or damage to materials resulting from theft, vandalism or any other cause whatsoever, shall be assumed by the Contractor from and after the delivery of any such materials to the project site. [Exh. P-2, Add. 91, 96; see also Stipulated Fact 7, Add. 40-41.]

Accordingly, all the direct-purchase provisions in the prime contract documents applied fully to the Subcontract, authorizing Alpine to purchase directly the mechanical and plumbing materials to be installed by Brown. Specifically, the "furnish and install" requirements of the Subcontract and plumbing specifications (Section 15D-Plumbing, Exh. P-3, R. 59, Add. 98) were modified by the direct-purchase provisions in the Alpine-Paulsen Agreement and Part J, paragraph 20, of the Supplementary Conditions, cited above. (Stipulated Facts 1, 7-8, 17-21, Add. 39-41, 45; Findings of Fact 6, 11-14, Add. 5-6; Tr. 18-20, 22-25, 155, 162, 170, 175.)[3]

Paulsen and Brown knew and understood, before construction began, that Alpine intended to exercise its right of direct purchase of materials for the Project. Part J, paragraph 20, of the Supplementary Conditions, authorizing direct purchases by Alpine, was part of the specifications upon which Brown based its bid. Brown understood, at the time of its bid, that it would not have to furnish or pay taxes on materials purchased directly by Alpine, and that its only duty with regard to such materials would be to install them. (Tr. 18-20.) At a preconstruction meeting with Paulsen, Brown and the other subcontractors, Harold Jacklin and Dennis Cecchini specifically discussed and explained the procedure for Alpine's direct purchase of materials set out in Part J, paragraph 20, of the Supplementary Conditions. Jacklin and Cecchini made "very clear" that Alpine was

[3] The original Subcontract, signed in June 1985, was superseded by the Subcontract included in the Record as Exhibit P-1, dated February 20, 1986. The two documents were identical, except that the contract price in the second agreement was reduced by the actual amount of direct purchases (and related sales tax savings) made by Alpine. (See notation at the top of the second agreement, Add. 118.) The purpose of the second agreement was merely to conform the contract price with the actual amount due as a result of the direct purchases. (Tr. 27-30, 55-56.) Mr. Cecchini, the Project Architect, who had the responsibility of interpreting the various contract documents, testified as an expert witness that signing the second subcontract had the same effect as a change order for direct owner purchases. (Tr. 138-39, 157.)

going to exercise the direct-purchase option, taking upon itself the responsibility for purchase and delivery of the plumbing materials, leaving with Paulsen the duty to approve and store the materials until installation by Brown. (Tr. 133-34, 141-44, 160.)

Throughout the construction period, Alpine maintained close supervision of the Project. Harold Jacklin monitored all phases of the Project and remained ultimately responsible to the Board of Education for satisfactory completion of the Project. He authorized all direct purchases, purchase orders, and payments for materials. Mr. Jacklin visited the Project site on at least a weekly basis and had authority to stop any part or all of the Project if necessary. John Holden, working under Mr. Jacklin's direction, inspected the Project almost daily, spending an average of 16 hours per week on the site. Holden made weekly progress reports to Mr. Jacklin. (Tr. 69, 72-74, 81, 95, 117, 137-38; Holden Dep. 11, 13-17; Stipulated Facts 25-33, Add. 46-47; Findings of Fact 9, 18-21, Add. 5-7.)

As provided in the contract documents and intended by the parties, Alpine directly purchased the mechanical and plumbing materials for which Brown subsequently received the tax notice under review. Alpine's general guideline to Paulsen and Brown was that Alpine would consider for direct purchase any materials that would yield a sales tax saving of $1,000 or more. Brown provided Paulsen a list of needed mechanical and plumbing supplies that satisfied that guideline, along with the respective suppliers and prices as contained in the original bid. Paulsen approved and passed that list on to Mr. Jacklin. (One such list, typical of others, was introduced as Exhibit P-5, R. 80, Add. 122.) Mr. Jacklin designated to Alpine's purchasing department specifically which items to purchase, and the purchasing department sent purchase orders for those items directly to the

suppliers. (Examples of Alpine purchase orders, typical of others, are included in Exhibit P-4, R. 69 and 76, Add. 125, 132.) The suppliers delivered the materials to the Project site, where they were inspected and approved by Mr. Holden and Paulsen or Brown, and then stored on site by Paulsen until incorporation by Brown. Invoices for the materials were sent by the suppliers directly to Alpine and approved for payment by Mr. Jacklin. Alpine then sent payment directly to the suppliers. (Examples of invoices and Alpine checks, typical of others, are included in Exhibit P-4, R. 70-75, 77-79, Add. 126-31, 133-35.) Exhibit P-8 (R. 87-88, Add. 136) is an accounting of all direct mechanical and plumbing purchases by Alpine, in the total amount of $465,110. Brown furnished only the remaining materials not purchased directly by Alpine. (Tr. 20, 46-48, 63-64, 74-78, 82-83, 86-88, 113-17, 123, 129, 155-56, 165-66; Stipulated Facts 21-23, 33, 36, 38, Add. 45-48; Findings of Fact 13-16, 21, 24, Add. 6-8.)

As evidenced by the foregoing procedures, all parties concerned regarded Brown's Subcontract as an "install only" contract with regard to the materials purchased directly by Alpine. Lee Brown, President of Brown Plumbing, testified that Alpine's direct purchase of the major plumbing materials relieved Brown of any duty to furnish, or to pay any tax on, those same materials; that Brown was not involved in the purchase or delivery of the direct-purchased materials, for which the challenged tax has been imposed; that Brown's only contractual duty with regard to those materials was to install them; and that any sales or use tax imposed on Brown for those materials will be passed on to Alpine. (Tr. 19-20, 23-24, 26-27, 31, 34, 56, 61.) Leon Lundquist, one of the plumbing-material suppliers, testified that he dealt directly with Alpine in filling out its purchase orders; and that he

regarded Alpine as the purchaser and owner of the materials; accordingly, he charged no sales tax on the direct purchases. (Tr. 97-99, 104-06; Exh. P-4, R. 72, 75, Add. 128, 131.) Mr. Cecchini, the Project Architect, testified as an expert witness that Alpine's exercise of the direct-purchase provisions of the contract documents rendered the Brown Subcontract an "install only" contract, imposing no duty on Brown to purchase and deliver the materials purchased by Alpine. (Tr. 138-39, 144, 154-55, 160, 175.)

The material incidents and burdens of ownership of the direct-purchased items fell on Alpine, not Brown. Most significantly, it was Alpine, not Brown, that actually paid for the materials in question. (Tr. 26-27, 115-17; Findings of Fact 4e, 4n, 4p, and 24, Add. 2, 4, 8.) Alpine assumed the risk of any price increases that occurred between the time of the original bid and actual purchase. (Tr. 31-32, 120-21, 155.) Alpine also assumed the burden of correcting any variances in quantity of materials shipped. (Tr. 121-22.) If any of the materials were defective or damaged in transit, Alpine corrected the problem with the supplier directly, as any warranty on the items ran to Alpine as owner. (Tr. 80, 92, 143; Stipulated Fact 24, Add. 45-46; Finding of Fact 17, Add. 6.) Title to the direct-purchased materials passed directly from the supplier to Alpine, without any vesting in Brown. (Stipulated Fact 16, Add. 44-45; Findings of Fact 4j and 10, Add. 3, 5-6.) Responsibility for inspection and approval of the materials after delivery to the Project site rested upon Alpine as owner and Paulsen as Contractor, although Brown also approved the materials as an accommodation to Paulsen to ensure they could be installed according to specifications. (Tr. 48-49, 74-75, 77, 87-88, 143; Findings of Fact 4m and 4n, Add. 4.) Paulsen, as Contractor, was responsible for storage of the materials, and for any damage

to the materials not caused by Alpine or Brown, prior to incorporation into the Project; Brown had no such responsibility, unless Brown's own employees caused the damage. (Tr. 32, 41, 56, 143; Stipulated Fact 35, Add. 48; Findings of Fact 4h, 4k, 4l, and 22, Add. 3, 7.) Alpine, through the State Risk Manager, provided fire and liability insurance on the direct-purchased equipment and materials; whereas Brown carried only a general liability policy that did *not* cover loss or damage to those materials. (Tr. 21, 118, 171; Stipulated Fact 37, Add. 48; Finding of Fact 23, Add. 8.) All the direct-purchased equipment and materials were incorporated into the Project; Brown retained none of them. (Stipulated Fact 23, Add. 45; Finding of Fact 16, Add. 6.) Finally, if the challenged tax is imposed on the direct-purchased materials, Alpine, not Brown, will pay the tax. (Tr. 34, 122; Finding of Fact 4p, Add. 4.)

Notwithstanding the contract provisions and facts showing Alpine to be the purchaser and owner of the major plumbing materials incorporated into the school Project, on March 12, 1987 the Utah State Tax Commission served Brown with a Statutory Notice of Deficiency assessing tax and interest on the direct-purchased materials in the amount of $30,508.83. (R. 234, Add. 26.) The first paragraph of the Notice refers to the assessment as a "sales tax deficiency," while the attached exhibit is labeled "SALES AND USE TAX ASSESSMENT." (Add. 26, 28.) Brown filed a Petition for Redetermination, explaining that the materials in question were purchased and owned by Alpine, and that Brown merely incorporated the materials into the Project as an independent subcontractor. (R. 292, Add. 30.) The Tax Commission's Answer alleges that Brown is liable for the

tax because Brown was obligated by its Subcontract "to furnish all labor and materials," whether or not Brown *actually* purchased the materials. (R. 287-89, Add. 36-38.)

Following discovery, the Tax Commission conducted a formal evidentiary hearing on the issues on July 11, 1991. Brown presented evidence, as documented above, that Alpine purchased and owned the materials, that Brown's only role was to incorporate those materials into the Project, and that the sales were therefore tax-exempt. Tax Commission auditors testified that the assessment was based solely on the assumption that the Subcontract was a "furnish and install" contract, without regard to Alpine's direct purchase of the materials, thereby making Brown the "consumer" of the materials. (Tr. 190, 195-96, 198-201.)

The Tax Commission upheld imposition of the tax. The Commission found that, while Alpine ordered, paid for, insured, and took title to the plumbing materials (Findings of Fact 4, 10, 17, 23-24, Add. 2-6, 8), Brown "had the burdens and benefits of ownership, and possessed control and ownership of the materials" (Finding of Fact 34, Add. 10). The Commission held that Brown is liable for the sales or use tax, even though it was not the purchaser, because Brown "consumed" the materials by converting them into real property. (Conclusions of Law 3-6, 21, Add. 10-11, 19-20.) The Commission never specified whether it was imposing a sales tax or a use tax, appearing to use the terms synonymously or alternatively. (See Decision and Order p. 24, Add. 24.) The Commission ruled that, in order for the sales to Alpine to be tax-exempt, Alpine must also be the "consumer" of the materials by acting as the "prime contractor" of the construction project. (Conclusions of Law 10, 13-20, Add. 12-19.) The Commission concluded that the fact the

tax would actually be paid by Alpine, a tax-exempt entity, had no legal significance. (Conclusion of Law 11, Add. 13.)

SUMMARY OF ARGUMENT

Sales of tangible personal property to state entities, such as Alpine, are exempt from sales and use taxes pursuant to 59-12-104(2) and Rule R865-19-42S, promulgated thereunder. Accordingly, Alpine's direct purchases of the school construction materials at issue in this case are not subject to taxation. The Tax Commission's assessment of a "sales and use tax" on Brown, solely on the basis that Brown installed the materials as a subcontractor, is contrary to Utah law and must be reversed.

The Commission cited no legal basis to justify imposing a sales tax on Brown. Section 59-12-103(1)(a) authorizes a sales tax only on the "purchaser" of the property. Alpine, not Brown, was the purchaser of the materials in question. Alpine ordered the materials from suppliers, received invoices from the suppliers, paid the suppliers directly, and received title to the materials directly from the suppliers. The Commission found that Alpine, not Brown, was the purchaser. The cases cited by the Commission in support of taxing the contractor as "consumer" of the materials are all distinguishable in the important respect that in each case the contractor, not the government, was the undisputed purchaser of the materials. The contractor-consumer rule has no application to a contractor who is not the purchaser of the materials.

Rule R865-19-58S provides no authority for assessing Brown with the tax because that rule, consistent with the statute, requires that the contractor be the purchaser and

owner of the materials. Here, Brown was neither the purchaser nor the owner. The Commission's decision violates the terms and intent of its own rule.

The Commission's conditions that, in order for a sale to be tax-exempt, the exempt entity install the materials either with its own employees, through an "install only" contract, or by acting as prime contractor, are unauthorized by statute and violate Rule R865-19-42S. Accordingly, they cannot be imposed as a basis for the Commission's decision. In any event, the conditions were satisfied in this case because Brown installed the materials on an "install only" basis, and Alpine retained all the significant incidents of ownership of the materials to qualify as "prime contractor" under the Commission's own analysis.

The Commission cited no legal basis to justify, alternatively, imposing a use tax on Brown. Section 59-12-103(1)(l) and Rule R865-19-58S authorize a use tax only on the "purchaser" of property purchased out-of-state for use or consumption in this state. Alpine, not Brown, was the purchaser, and the property was purchased in Utah. Moreover, Utah law prohibits imposing a use tax on property that is exempt from the sales tax. Accordingly, the Commission's imposition of a use tax must be reversed.

Finally, the tax violates 59-12-104(2) because the burden of paying the tax falls on Alpine, a tax-exempt entity. The tax violates the Utah Constitution by interfering with the exclusive power of the Legislature to determine who is taxed and how tax revenues will be appropriated. Imposing a tax on public school construction materials also unlawfully forces diversion of funds from education to noneducational purposes.

ARGUMENT

POINT I: THE TAX COMMISSION ERRED IN IMPOSING A SALES TAX ON BROWN, AS SUBCONTRACTOR, FOR SCHOOL CONSTRUCTION MATERIALS PURCHASED DIRECTLY BY ALPINE AS A TAX-EXEMPT ENTITY.

The Tax Commission recognized that sales to state entities, such as Alpine, are tax-exempt under U.C.A. § 59-12-104(2). (Conclusion of Law 1, Add. 10.) However, the Commission held that Brown is liable for sales tax on the plumbing materials in question because Brown "consumed" those materials by installing them into the school building. "That conversion of tangible personal property into real property is deemed to be the consumption or use of the tangible personal property, which is the taxable event." (Decision and Order p. 20, Add. 20.) Because it is the building contractor that typically incorporates construction materials into a building, the Commission reasoned that "the primary issue in this case is to determine whether [Brown] or [Alpine] was the real property contractor." (Id. p. 21, Add. 21.) The Commission concluded, in somewhat circular fashion, that because Brown converted the materials into real property, Brown was the real property contractor and was therefore liable for the sales tax. (Id.) Respectfully, the Commission's analysis is strained and misdirected in that it focuses entirely on the identity of the "contractor" or "consumer" of the materials and overlooks the vital threshold question of who was the *purchaser* of the materials.

A. No Statutory Basis For Sales Tax

Section 59-12-103(1), U.C.A. sets forth the essential premise in our sales and use tax scheme that the tax is imposed on the *purchaser*:

> (1) There is levied a tax *on the purchaser* for the amount paid or charged for the following:
>
> (a) retail sales of tangible personal property made within the state;
>
> . . . .
>
> (l) tangible personal property stored, used, or consumed in this state. [Add. 142, emp. added.]

"Retail sale" is defined as any sale "to a user or consumer." 59-12-102(8)(a) (Add. 139). "Sale" refers to transfer of title for a consideration. 59-12-102(10) (Add. 140). Thus, by the express terms of the statute, sales tax is levied on the *purchaser* of the property. The purchaser is the party that orders the property, pays the consideration, and receives title to the property. *See, e.g., Alabama v. King & Boozer*, 314 U.S. 1, 10 (1941) (purchaser of tangible goods is the person who orders and pays for them or is obligated to pay for them). Yet, the Tax Commission focused only on the word "consumed" in subsection (l), without reference to or consideration of the word "purchaser" in the prefatory language to which that subsection pertains. (Decision and Order p. 20, Add. 20.) The Commission made no finding that Brown purchased the materials for which the tax was imposed. In fact, to the contrary, the Commission conceded that Alpine was the purchaser of the materials. (Findings of Fact 4, 10, 15-16, 21, 24, Add. 2-8.)[4]

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[4] The only statutory references in the Tax Commission's decision are to 59-12-103 and -104. (Conclusions of Law 1-2, Decision and Order p. 20, Add. 10, 20.) Section 59-12-103(1)(a) is the sales tax provision; section 59-12-103(1)(l) is the use tax provision; and section 59-12-104(2) is the tax-exemption for state entities. These sections were codified in their present form in 1987. Prior to 1987, the sales tax provision appeared as 59-15-4(a); the use tax provision appeared as 59-16-3(a); and the state tax-exemption appeared as 59-15-6(1)(a). (Add. 159; see Amendment Notes to sections 59-12-103 and -104 in 1987 Replacement Volume 6B, Add. 143, 147-48.) Because the sales at issue in this case occurred in 1985, it would appear that the former tax provisions should apply. However, because there appears to be no material change in the applicable provisions and definitions between 1985 and 1987, Brown does not

The Tax Commission relied on three Utah cases for the proposition that a building contractor may be assessed a sales tax on the basis that the contractor is the "consumer" of the materials. (Conclusion of Law 4, Decision and Order pp. 20-21, Add. 10-11, 20-21.) However, all three cases are distinguishable on the basis that in each case the contractor was also the undisputed actual purchaser of the materials. For example, in *Utah Concrete Products Corp. v. State Tax Commission*, 101 Utah 513, 125 P.2d 408 (1942), the plaintiff taxpayer manufactured and sold concrete products to contractors for use in state highway construction. The plaintiff argued that the sales to contractors were tax-exempt because they were not "retail sales," as used in the taxing statute, and because the contractors purchased the products as "instrumentalities of the state," a tax-exempt entity. *Id.*, 125 P.2d at 409-11. Relying upon the statutory definition of "retail sale," which included sales to "a user or consumer," id. at 410, the Court concluded that the contractors who purchased the products "are consumers within the meaning of our act because they are the last persons in the chain to deal with such products before incorporation into a separate entity." Id. at 411. The Court held that selling to contractors on behalf of the state did not render the sales tax-exempt because the sales were not directly to the state:

> It is true that under this section [exempting sales to the state] *sales made directly by plaintiffs to the state would be exempt*, but in the instant case the sales are to an independent contractor and not to an agent of the state. [*Id.*, emp. added.]

As evidence that the contractors were the purchasers, the Court noted that "plaintiffs . . . look solely to the contractors for their payment, and not to the state." *Id.*

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challenge the Commission's reliance on the later version of the statutes.

Similarly, in *Olson Construction Co. v. State Tax Commission*, 12 Utah 2d 42, 361 P.2d 1112 (1961), the plaintiff taxpayer subcontracted to construct buildings for the federal government. The subcontractor claimed that its purchases of construction materials should be tax-exempt because the construction contracts provided that title to the materials would vest in the government upon delivery to the construction site. The Court followed the holding in *Utah Concrete Products* that "contractors, engaged in the construction of a public project for a lump sum, were 'consumers' . . . of the materials *purchased and used by them* in the performance of their contract." *Id.*, 361 P.2d at 1113, emp. added. The Court held that the title-shifting provision in the contracts did not alter the fact that the subcontractor purchased the materials for the purpose of incorporating them into the buildings. Because the subcontractor was both the purchaser and consumer, the sales were not tax-exempt. *Id.*

In the third, and most recent, case relied upon by the Tax Commission, *Tummuru Trades, Inc. v. Utah State Tax Commission*, 802 P.2d 715 (Utah 1990), the taxpayer sought a tax-exemption for construction materials it purchased as contractor for use in out-of-state projects. Again, the Court followed its holding in *Utah Concrete Products* that "contractors were the ultimate consumers of the items *they purchase* for incorporation into various forms of real estate." *Id.* at 718, emp. added. Because the contractor purchased and took possession and title to the materials in Utah, the sales were not exempt, even though the conversion to real property would occur out-of-state. *Id.* at 719.

Thus, the cases relied upon by the Tax Commission uniformly stand for the unquestioned rule that a contractor who *purchases and "consumes"* building materials by

converting them into real property is liable for the sales tax. But that rule has no application to this case because Brown is not the purchaser of the materials for which the tax is assessed; Alpine is the purchaser. Alpine ordered the materials, was contractually obligated to pay for them, and did pay for them.

The Tax Commission is attempting to stretch the contractor-consumer rule to apply to contractors who do *not* purchase the materials, but merely install them. However, there is no support in Utah law for that position. The tax at issue is a "sales" tax, not a "consumption" tax. To suppose that a sales tax may be imposed upon a contractor merely for installing materials purchased by the real property owner defies both reason and law. Under the Commission's decision, a contractor who is hired by a homeowner to install roofing shingles purchased by the homeowner would be subject to a sales tax merely on the theory that he "consumed" them by installing them. However, the taxable event is *not*, as the Commission surmised, the "consumption" of the materials, but the *sale* of the materials. The cases have applied a consumption analysis only to determine whether the sale was a "retail sale," as defined in the law; that is, to determine whether the purchaser is also the consumer, making the sale taxable to the purchaser. If the purchaser does not "consume" the materials, but holds them for resale, the purchase is not taxable. The Commission's rationale ignores the purchase and the purchaser and taxes the supposed "consumer." However, in order for the contractor to be the consumer, he must first be the purchaser. If the contractor is not the purchaser, then the consumption analysis does not even apply. If, as here, the state is the purchaser of the materials, the sale is tax-exempt, regardless of the contractor's role in converting them to real property, as the

Court expressly acknowledged in *Utah Concrete Products*. 125 P.2d at 411. *See also Nickerson Pump & Mach. Co. v. State Tax Commission*, 12 Utah 2d 30, 361 P.2d 520 (1961) (emplacement of pumps sold to government nontaxable); *Briggs v. Page*, 221 N.Y.S.2d 843 (App. Div. 1961) (contractor not liable for sales tax on construction materials purchased directly by tax-exempt entity and installed by contractor).

In summary, the sales tax statute limits imposition of the tax to the *purchaser* of the items, precluding the sales tax assessment on Brown.

B. No Regulatory Basis For Sales Tax

The Tax Commission repeatedly cited Rule R865-19-58S, Utah Administrative Code, in support of its conclusion that Brown is liable for the tax as "consumer" of the materials. (Conclusions of Law 3-9, 11, 20, Decision and Order p. 24, Add. 10-13, 17-19, 24.)[5] However, the language of the Rule is contrary to the Commission's conclusion. To the extent any part of that Rule *may* be construed to support the Commission's decision, it is unauthorized and unenforceable as contrary to the statutes and cases discussed above. *E.g. Olson Construction Co. v. State Tax Commission*, 12 Utah 2d 42, 361 P.2d 1112, 1113 (1961) (administrative regulation contrary to statute is invalid).

Rule R865-19-58S provides in relevant part:

> **A.** Sale of tangible personal property to real property contractors and repairmen of real property is generally subject to tax.

[5] As with the applicable statutes, the Tax Commission relied upon the current version of the Rule, R865-19-58S (Add. 150), rather than the version that existed in 1985, Tax Regulation A12-02-S58a (Add. 172). However, because the differences in wording between the two are minor, no objection is made.

> 1. The person who converts the personal property into real property is the consumer of the personal property since he is the last one to own it as personal property.
>
> 2. The contractor or repairman is the consumer of tangible personal property used to improve, alter or repair real property; regardless of the type of contract entered into--whether it is a lump sum, time and material, or a cost-plus contract.
>
> 3. . . . [S]ales of materials and supplies to contractors and subcontractors are taxable transactions as sales to final consumers. This is true whether the contract is performed for an individual, a religious institution, or a governmental instrumentality.
>
> 4. Sales of materials to . . . government agencies are exempt only if sold as tangible personal property and the seller does not install the material as an improvement to realty or use it to repair real property. [Add. 150.]

Construed in its entirety, this Rule does *not* support taxing a contractor, merely because he installed the building materials, unless the contractor is also the *purchaser* of the materials. The prefatory language in part A. limits application of the Rule to a "sale" of property "*to real property contractors*," meaning the contractor is the actual purchaser of the property. The subsequent numbered subparts are valid only if they assume compliance with the purchase requirement in part A. Subpart A.1. provides that the contractor is the "consumer" of the property only if "he is the last one to *own* it as personal property." Since Brown never held title to the materials in question (Findings of Fact 4j and 10, Add. 3, 5-6), Brown did not "own" them and cannot be considered their "consumer." Subpart A.3. also limits taxability to "sales of materials and supplies *to*

contractors," thereby excluding sales made directly to exempt real property owners, such as Alpine in this case. Subpart A.4. also supports a tax-exemption in this case because the sales were made to Alpine, and the "sellers" or suppliers did not "install the materials." That leaves only subpart A.2., which, if construed consistent with the surrounding subparts, would also properly require that the "consumer" first be the purchaser of the property. If read in isolation, subpart A.2., in imposing a tax on the contractor "regardless of the type of contract," is simply invalid as contrary to the controlling statutes and cases, discussed above, which permit taxing the contractor only if the contract is the "furnish and install" variety.

In summary, the Commission's decision is contrary to its own rgulation. The sales tax regulation relied upon by the Commission authorizes imposition of the tax on the contractor only if he is also the *purchaser* of the materials, precluding the assessment on Brown in this case.

C. <u>No Other Legal Basis For Sales Tax</u>

Having established that the applicable statutes and regulations limit imposition of a sales tax to the purchaser of the materials, the analysis now shifts to a discussion of whether Alpine's purchases qualify for the exemption. The Tax Commission concluded that sales to an exempt entity, such as Alpine, are exempt from tax only if the exempt entity is also the "consumer" of the property, as determined by whether: (a) "the exempt entity has its own employees attach the materials and/or supplies to the realty"; or (b) "the exempt entity separately hires a contractor to attach the materials and/or supplies to the realty on a labor only or install only contract"; or (c) the exempt entity "acts as the

prime contractor by converting the tangible personal property to real property." (Conclusion of Law 13, Add. 13-14.) However, the Commission cites no authority for imposing these conditions on exempt entities in order to claim their rightful exemption.

As noted above, section 59-12-104(2) *unconditionally* exempts sales to the state and its political subdivisions. The statute imposes no requirement that the exempt entity also be the "consumer" of the materials or "contractor" for installation of the materials. The Tax Commission is apparently confusing the unconditional tax-exemption in 59-12-104(2) with the conditions for a sales tax on *non-exempt* entities under 59-12-103(1). However, the two statutes operate independently of each other. If a sale is to an exempt entity, there can be no tax, regardless of whether the sale could be taxed if it were to a non-exempt entity. If a sale is to a state entity, that should end the inquiry, as plainly affirmed in Rule R865-19-42S, Utah Administrative Code:

> A. Sales made to the state of Utah, . . . or to its political subdivisions such as . . . school districts, . . . are exempt from tax if such property [sic] for use in the exercise of an essential governmental function. If the sale is paid for by a warrant drawn upon the state treasurer or the official disbursing agent of any political subdivision, the sale is considered as being made to the state of Utah or its political subdivisions and exempt from tax. [Add. 149.]

While 59-12-104(2) imposes no requirement that the property be used "in the exercise of an essential governmental function," there is no suggestion in this case that that requirement was not satisfied. Moreover, there is no question that the purchases were made by Alpine's "official disbursing agent." (Finding 21, Add. 7.) Accordingly, the purchases by Alpine are tax-exempt without regard to the Tax Commission's artificial and

unauthorized conditions. In any event, the Commission's condition (b) above, was plainly satisfied in this case, and condition (c) may be satisfied in the alternative.

The Commission's condition (b) was satisfied because Alpine *did* hire a contractor to attach the materials on an "install only" contract. The Commission's auditors testified that they assessed the deficiency against Brown only because they believed that the Subcontract was a "furnish and install" contract, requiring Brown to purchase the plumbing materials. (Tr. 190, 196, 199.) They were unaware of Alpine's direct supervision of the Project, Alpine's direct purchases of plumbing materials, and the reduction in the Subcontract to reflect those purchases; they did not consider such involvement to be relevant. (Tr. 198-201.) Accordingly, the deficiency assessment was based on a misunderstanding of the terms and operation of the Subcontract.

The Tax Commission itself misread or misunderstood the direct-purchase provisions in the contract documents, leading the Commission to the erroneous conclusion that Brown remained obligated to furnish the materials purchased by Alpine. For example, in Findings 4s, 25, and 28, the Commission refers to contract language stating that the direct-purchase provisions do not relieve Paulsen or Brown from their duty to furnish materials. (See Add. 61, 98, 101.) The Commission misconstrued that language to mean that Brown remained obligated to furnish plumbing materials even *after* those same materials were purchased directly by Alpine. (See Decision and Order p. 23, Add. 23.) However, that interpretation is contrary to the contract language, the intent of the parties, and reason. The contract language relied upon by the Commission merely meant that the unexecuted direct-purchase provisions *by themselves* did not relieve Paulsen or Brown from their

"furnish" requirements, because Alpine could still choose *not* to exercise the direct-purchase option. However, once Alpine actually exercised the direct-purchase option and purchased the plumbing materials, obviously Brown was relieved from any duty to furnish those same materials. As to those direct-purchased materials, the Subcontract was an install only contract. (Tr. 19, 23, 61, 144, 160, 173, 175.)

The Commission's conclusion that Brown remained obligated to furnish the same materials already purchased by Alpine is also contrary to the Commission's other findings that: Brown's "furnish and install" obligation was "subject to provisions for change orders" (Finding 6, Add. 5); Alpine "could amend the contract by change order and also subtract a contract sum from the total contract it so desired" (Finding 8, Add. 5); "[t]he contracting documents provided for change orders" (Finding 13, Add. 6); and "[c]hange orders were made to the subcontract for materials directly purchased by the [Owner]" (Finding 14, Add. 6). If the Subcontract was amended by change orders for Alpine's direct purchase of materials, as the Commission expressly found, then the Subcontract provisions requiring Brown to furnish those same materials were plainly superseded and rendered void. Accordingly, Brown *was* hired on an "install only" basis as to the materials purchased by Alpine, and the Commission's condition (b) for tax-exemption applies[6]

Regarding imposed condition (c), whether Alpine was acting as "prime contractor" on the Project, the Tax Commission ruled that Alpine's involvement "did not rise to the level of the real property contractor because [Alpine] did not assume the burdens, risks,

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[6] The Tax Commission also observed that a sale of personal property to an exempt entity may be subject to tax "if the exempt entity is simply acting as the purchasing agent for the general contractor." (Conclusion of Law 14, Add. 14.) However, the Commission did not find that that situation existed in this case.

responsibilities and incidents of ownership of the materials being converted to real property." (Decision and Order p. 22, Add. 22.) However, that ruling is not supported by the evidence or by the Commission's own findings and analysis.

The Commission concluded, again without citation of authority, that for an exempt organization to act as the prime contractor it must: a) "[e]xercise direct supervision over the construction project"; b) "[i]ssue purchase orders to the vendors for all materials and supplies for which the tax is not paid"; c) "[m]ake direct payment to the vendors" for all such materials; and d) "[h]ave provisions in any furnish and install contracts to permit changes through change orders to make that portion of the contract a labor only or install only contract . . . ." (Conclusion 17, Add. 16.) All of those conditions were satisfied, as documented in the Statement of Facts and supported by the Commission's own findings. Alpine exercised direct supervision over the Project (Findings 7-9, 18-21, Add. 5, 7); Alpine issued purchase orders and made direct payment for materials (Findings 4, 10, 16, 21, and 24, Add. 2-8); and change orders made the Subcontract an install only contract as to the direct-purchased materials (Findings 12-16, Add. 6). The Commission then adds the general condition that the exempt entity "must exercise sufficient direct supervision over the purchased materials that there is a change in the legal status of which entity is responsible for those materials." (Conclusion of Law 18, Add. 16-17.) This requirement refers to the exempt entity's assumption of the burdens or incidents of ownership of the materials. (Conclusions of Law 19-22, Add. 17-20.)

The Commission's findings that Alpine did not assume the burdens and incidents of ownership of the materials (Findings 26-34, Add. 8-10) are contrary to the Commission's

other findings. As documented in the Statement of Facts, Alpine ordered the materials, paid for the materials, assumed the risks of price and quantity variances, assumed responsibility to correct defects, took legal title to the materials, participated in inspection of the materials upon delivery, insured the materials, and will assume the expense of the tax if the assessment is upheld. (Findings 4, 10, 14-17, 21-23, Add. 2-8.) The Commission's rationale cannot be supported by inconsistent findings. *See, e.g., Boice v. Industrial Claim Appeals Office*, 800 P.2d 1339, 1342 (Colo. App. 1990).

Certain of the Commission's findings with respect to Alpine's ownership of the materials are simply contrary to the evidence. For example, Finding 26, that Alpine did not participate in receipt or inspection of the materials, is presumably based on the evidence that Paulsen and Brown inspected and approved the materials upon delivery. (Tr. 77, 87-88.) However, that evidence does not negate the fact that Alpine's employees also participated in, and had ultimate responsibility for, the inspection of materials. (Tr. 74-75.) Finding 27, that Brown was responsible for defects in the direct-purchased materials, is presumably based on the evidence that Brown helped to obtain replacement of a defective boiler. (Finding 33, Add. 10; Tr. 89-90.) However, that evidence does not alter the facts that Alpine also contacted the supplier of the boiler (Tr. 80, 92), that all warranties ran to Alpine as owner (Finding 17, Add. 6), that Alpine was responsible for all damage in transit (Tr. 143), and that the direct-purchase change orders relieved Brown of responsibility for defects in the direct-purchased materials (Tr. 22-24, 41, 55, 61, 144, 154, 160). Finding 29, that the risks of ownership were on Brown, is apparently based on the contract language in Finding 30 that the "contractor" would hold Alpine harmless for

loss of or damage to the materials. However, here the Tax Commission confuses Paulsen (the "contractor"), who did assume responsibility as bailee of the materials after delivery (Findings 4g, 4h, 4k, 4l, Add. 3), with Brown (the subcontractor), who assumed no such responsibility (Tr. 32, 41, 55-56). Alpine also bore the risk of loss during storage through its state insurance. (Finding 23, Add. 8.)

Thus, the Commission's conclusion that Brown, rather than Alpine, bore the burdens of ownership of the materials is not supported by the findings and the evidence. The Commission's findings and conclusions to the contrary are conflicting and are based on selective, partial quotations from the contract documents that were superseded or amended by change order and the conduct of the parties. *See Eie v. St. Benedict's Hosp.*, 638 P.2d 1190, 1195 (Utah 1981) (actions of parties to contract demonstrate intent and will be enforced even if contrary to contract language). Moreover, Alpine had all the important incidents of ownership to qualify as "prime contractor," and thus "consumer" of the materials, under the Commission's analysis.

In summary, the Commission's artificial conditions for an exempt entity to receive its exemption are nowhere authorized in the law. Section 59-12-104(2) does not mention that the exempt entity must also be the "consumer" of the materials or the "contractor" on the building project. The "consumer" concept is relevant only to the taxing statute in defining a "retail sale," 59-12-103(1)(a); it has no relevance to the exemption statute. Moreover, a school district should not have to go into the business of construction contracting in order to claim its lawful exemption. Even if the Commission's conditions are applied, Alpine's purchases qualify for exemption because they were effected under

an install only contract, and Alpine retained all the significant aspects of ownership of the materials.

Because there is no statutory, regulatory, or other legal basis for imposing a sales tax on Brown for materials purchased directly by Alpine, the Tax Commission's Decision and Order upholding the assessment must be reversed.

POINT II: THE TAX COMMISSION ERRED IN ALTERNATIVELY IMPOSING A USE TAX ON BROWN, AS SUBCONTRACTOR, FOR SCHOOL CONSTRUCTION MATERIALS PURCHASED IN UTAH BY ALPINE AS A TAX-EXEMPT ENTITY.

As noted previously, the Tax Commission does not clearly state whether it is imposing a sales tax or a use tax on Brown. The Notice of Deficiency refers to a "sales tax deficiency." (Add. 26.) The attachment to the Notice refers to the assessment as a "sales and use tax." (Add. 28.) The Answer to Petition for Redetermination refers to the assessment merely as "the tax." (Add. 38.) The Tax Commission's first factual finding is: "The tax in question is sales and use tax." (Add. 1.) The Conclusions of Law typically refer to "sales and use tax." (*E.g.*, Conclusions 1 and 2, Add. 10.) The Decision and Order also refers to a unitary "sales and use tax." (E.g., p. 20, Add. 20.) But the final page of the Decision and Order concludes that Brown is liable for a "use tax." (Add. 24.) Apparently, the Tax Commission either is not sure whether the assessment is a sales tax or a use tax, or it is simply trying to cover all bases and is asserting alternative grounds for liability. Whatever the Commission's intent, the law plainly does not support imposition of a use tax in this case.

Section 59-12-103(1)(l) authorizes "a tax on the *purchaser* for the amount paid or charged for . . . tangible personal property stored, used, or consumed in this state." (Add.

142, emp. added.) As discussed in detail, above, with reference to a sales tax, any use tax under this section could be assessed only on "the purchaser." Since Alpine, not Brown, was the purchaser of the materials in question, no use tax can be assessed to Brown. For the same reason, Rule R865-19-58S, cited by the Commission as the basis for a use tax (Decision and Order p. 24, Add. 24), provides no authority for assessment of a use tax on Brown.

In any event, case law makes abundantly clear that a use tax may be imposed only on goods purchased out-of-state for use in this state, and that property purchased in Utah, which is not amenable to sales tax, is likewise not subject to use tax. *For example,* in *Union Portland Cement Co. v. State Tax Commission*, 110 Utah 152, 176 P.2d 879 (1947), the Court traced the history and purpose of the use tax and explained that its purpose was to complement the sales tax by imposing a tax on the use of property purchased out-of-state, beyond the reach of our sales tax, and brought into this state. Id., 176 P.2d at 881-82. Because the use tax is intended to complement the sales tax, the Court held that a transaction that is exempt from sales tax should also be exempt from use tax:

> [I]t follows rather conclusively that the Sales and Use Tax Acts are to be considered as correlative and complementary and that, as far as exemptions are concerned, legislative created specific exemptions from the sales tax are also to be treated as exemptions from the use tax. [*Id.* at 881.]

That rule of law was subsequently confirmed in *Geneva Steel Co. v. State Tax Commission*, 116 Utah 170, 209 P.2d 208 (1949), which held that the use tax applies to the "storage, use or other consumption of *property purchased outside of this state* and brought into this state for storage, use or other consumption." *Id.*, 209 P.2d at 211, emp. added. The use tax has no application to property purchased *within* this state:

> We hold therefore, that the storage, use or other consumption of property, *the sale of which is made in this state and which is not made amenable to the sales tax, is likewise not subject to the use tax.* [*Id.*, emp. added.]

See also Barrett Investment Co. v. State Tax Commission, 15 Utah 2d 97, 387 P.2d 998, 999 (1964) (sales and use taxes are complementary so that transaction exempt under one is also exempt under the other); *Nevada Tax Commission v. Harker & Harker, Inc.*, 699 P.2d 112, 114 (Nev. 1985) (denied use tax on government contractor for materials used in performing government contracts because contractor was not owner of materials).

Applying the foregoing rules to this case, it is evident that Brown cannot be assessed a use tax. First, Alpine, not Brown, was the purchaser of the materials. Second, Alpine indisputably purchased the subject materials in Utah, and the use tax has no application to in-state sales. And third, because Alpine's purchases are exempt from the sales tax, as demonstrated in Point I, above, they are also exempt from the use tax. The Tax Commission may not defeat a statutory exemption from sales tax by simply imposing a use tax. *E.g., Union Portland Cement, supra*, at 882.

In summary, there is no legal basis for imposition of a use tax on Brown for installing materials purchased in Utah by Alpine as a tax-exempt entity. Accordingly, the Tax Commission's decision must be reversed.

POINT III: THE TAX COMMISSION VIOLATED STATE STATUTE AND THE UTAH CONSTITUTION BY IMPOSING AN EFFECTUAL TAX ON ALPINE AS A TAX-EXEMPT ENTITY.

The tax-exemption for state entities in 59-12-104(2) states:

> The following sales and uses are exempt from the taxes imposed by this chapter:

. . . .

(2) sales to the state, its institutions, and its political subdivisions. [Add. 144.]

Representatives of both Brown and Alpine testified that the tax assessed to Brown for materials purchased by Alpine will be paid by Alpine.[7] Accordingly, the tax violates the foregoing exemption provision.

The separation of powers provision of the Utah Constitution, Article V, § 1, precludes one branch of state government from exercising, or interfering with the exercise of, powers delegated to another branch:

> The powers of the government of the State of Utah shall be divided into three distinct departments, the Legislative, the Executive, and the Judicial; and no person charged with the exercise of powers properly belonging to one of these departments, shall exercise any functions appertaining to either of the others, except in the cases herein expressly directed or permitted. [Add. 151.]

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[7] Lee Brown testified:

> Q If this commission eventually decides that Brown Plumbing & Heating is responsible for the sales tax . . . for which you have been assessed, do you have an understanding as to who will ultimately be responsible to pay that tax?
>
> A I would expect the owner to pay that.
>
> Q Why would you have that expectation?
>
> A Because through the general contractor he deducted that from my contract. [Tr. 34.]

Alpine's accountant testified similarly:

> Q Do you have an understanding of who will be ultimately responsible for the tax on this matter if Brown Plumbing is deemed to be responsible for the tax here?
>
> A . . . [M]y understanding was that the agreement at the time if sales tax had to be paid the district would then relieve Mr. Brown of that and take care of that. [Tr. 122.]

The Legislature possesses the exclusive power to levy taxes, including the sales tax, and to appropriate revenues for operation of state government, including public education. Utah Const.: Art. VI, § 1; Art. X, §§ 1 and 5; Art. XIII, § 12 (Add. 152-58). The Tax Commission, an executive body, has only the authority to administer the tax laws as authorized by the Legislature; it has no authority to control who must pay the tax or how tax revenues will be apportioned. Utah Const. Art. XIII, § 11 (Add. 156-57). *See, e.g., Western Leather & Finding Co. v. State Tax Commission*, 87 Utah 227, 48 P.2d 526, 528 (1935) ("The imposition of a tax and the designation of those who must pay the same is such an essential legislative function as may not be transferred to others."); *Tite v. State Tax Commission*, 89 Utah 404, 57 P.2d 734, 740-41 (1936) (Commission's determination of tax penalty violated separation of powers).

The Commission's imposition of a tax on Brown for materials purchased by Alpine results in an encroachment by the Commission into the exclusive taxing and appropriation powers of the Legislature. The assessment results in an unlawful tax on Alpine, an exempt entity, thereby defeating the Legislature's designation of who shall and shall not be taxed. If school districts are required to pay sales tax on all materials used in the construction of school buildings, either directly or through higher bids to contractors who must pay the tax, the districts will have to increase their construction budgets, and a significant percentage of those funds will be diverted through the sales tax back into the general fund for reallocation to noneducational uses. The tax thereby interferes with the Legislature's exclusive appropriation power and defeats the legislative intent to maximize education funding.

This diversion of funds from education violates not only the separation of powers, but Article XIII, § 12(3) as well, which requires all revenue received from income taxes to be allocated to the support of the public school system. *See* U.C.A. § 53A-16-101.

In summary, the Tax Commission's decision must be reversed as violative of Alpine's statutory exemption and constitutional provisions regarding separation of powers and education funding.

CONCLUSION

Based on the foregoing, this Court should reverse the decision of the Tax Commission and order that Alpine's purchases of school construction materials are tax-exempt.

DATED this 12th day of August, 1992.

Respectfully submitted,

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CERTIFICATE OF MAILING

I hereby certify that I caused to be mailed two true and correct copies of Petitioner's Brief and Addendum to Petitioner's Brief on the 12th of August, 1992, by United States mail, postage prepaid, to the following:

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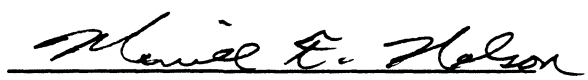

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